

Is Buy and Hold a Thing of the Past?

Many clients have asked this question in the past few months. I don't know if it is because of the internet, business news channels or the fact the stock market has been down the last few years but either way it has been a hot topic.

The real question that should be asked is whether the strategy of buying a stock in a good company and forgetting about it was ever a good idea. Could it be an investment myth; just like the thought that homes never lose value?

I think the myth started in the 1960's and 1970's with the notoriety of the nifty-50. These were companies that became known as "one-decision" stocks. Investors were told they could buy and hold forever. They were credited with propelling the bull market of the early 70's.

Examples of nifty-50 stocks included General Electric, Coca-Cola, Xerox, Polaroid and IBM. It seemed to work for a period of time, but some of the companies like Polaroid and Xerox have not fared well for years or even gone out of business. Even the companies that seemed to have done well over the last 20-30 years have had problems. For example; GE is down 70% in the last 18 months. Looking over the list of companies you find only a few have fared well over a 20-30 years period. So buy and hold forever is an investment myth. This does not mean that you can't buy a stock and hold it long term. You just can't forget about it.

What is a good strategy both long and short term? The one commonality among companies that have done well long term is consistent earnings growth. Thus, it would be important when judging whether a company belongs in a portfolio to focus on earnings. This is exactly what Marshall & Sullivan does when it determines which stocks to buy, sell and hold for our clients.

We start by looking for good companies that have a proven track record of growing their earnings and

are projected to have this trend continue. We have found in our 28 year history that once emotion is factored out, a stock price follows its earnings. If the company earns more today than it did 5 years ago its stock should go up in value.

The stock price also wouldn't increase if you paid too much for the company. To insure we don't pay too much, we look at how much we have to pay for a company's earnings. We do this by looking at the price to earnings to growth ratio. If the company is fairly valued and has growing earnings, the only other thing we focus on is strong financials. If these items are in place and it fits into our portfolio, we purchase a company's stock.

This sounds a little like the nifty 50 philosophy but instead of forgetting about them we follow them closely. We establish they are continuing to grow their earnings and if they can't we sell the company. The other factors that make us sell all or a portion of a position are companies becoming overvalued compared to their earnings growth or becoming too large a percentage of our portfolios.

During 2007 and 2008 we did more selling than buying. This has to do with the recession we are in. It is hard for a company to grow its earnings when the economy is pulling back. The recession and subsequent market pull back has given us some opportunities to add companies that were once over valued, especially the last few months. We feel that these companies, which have been able to grow their earnings in this economic environment, will be able to grow their earnings even faster as the economy turns around. With negative market emotions starting to turn more positive and earnings continuing to grow, these companies' stock prices should go up over time.

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